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PRELIMINARY SURVEY OF INDUSTRIAL RECONSTRUCTION

Industrial reconstruction after the war might be left to take its own course without governmental interference, just as industrial preparation for war might have been left free but was not. The free operation of economic laws would result in wide price fluctuations, unemployment and prolonged business depression due to shattered values, suspension of credit and cessation of work. There would seem to be no need, therefore, of any argument to show that the government should assist wherever necessary by artificially stimulating and restraining natural economic forces.

It is vitally necessary, however, in planning governmental supervision of the reconstruction process, to divide the problem into its elements and to analyze the economic forces which are involved. Industrial reconstruction cannot be effected merely by reversing the present machinery of control. The machine must be taken apart and reorganized to meet widely different conditions, the exact nature of which should be definitely comprehended in advance.

The following are the elements of the problem: (1) Stimulation of a demand for the products of industry to take the place of government buying; (2) Restoration of a normal price level; (3) Conversion of industrial facilities from war to peace production; (4) Absorption of labor released from war industries and from the military establishment.

As a basis for a discussion of the purpose and form of governmental regulation during the reconstruction period, I will undertake to describe briefly the nature of each of the four elements.

1. *Stimulation of a new demand.*—The extent of this problem depends immediately upon the government's policy respecting its outstanding war contracts. If government purchases were sharply curtailed, industry would suffer for want of a market unless an effective demand arose from other sources.

An inventory of government contracts and a summary of the permanent needs of the military establishment should be prepared immediately as a basis for determining what classes of contracts should be canceled. The first class to be canceled would embrace contracts for the production of those raw materials of which there may already be an oversupply. The last would be contracts nearing completion. Purchases for the maintenance of the military establishment will of course continue as long as there are men under arms, but a much more economical buying program can be laid down the moment hostilities are ended for the reason that the government's policy will be changed from one of discounting an uncertain future to discounting a known future.

In any event, the government demand will fall off sooner or later and must be replaced. The problem can be approached by classifying the character of demand between (*a*) domestic and (*b*) export.

There will almost certainly be a strong tendency to minimize the importance of the domestic demand and exaggerate the importance of the export demand, a mistake which should be avoided.

The export demand will depend primarily upon the policy of the government respecting the extension of credits, particularly to France, Belgium, Serbia, and Russia for their own rehabilitation and reconstruction, and secondarily upon the price at which American industry can afford to sell abroad in competition with foreign producers. Even under the most favorable conditions, however, the extent of the export demand may not reach expectations because of limited shipping facilities and the fact that most of the warring nations will find themselves in the same situation of needing foreign markets for their products.

Stimulation of an effective domestic demand is the hope of the country and this depends upon maintaining the sequence of business prosperity at home; that is, activity in industry, full employment, profits for the entrepreneur, and wages for labor that leave a margin over bare subsistence. The cessation of industries reduces demand. A sharp contraction of wages diminishes buying power and reduces demand; wide price fluctuations have the same effect.

After-the-war demand must not be estimated on the basis of what the country is able to produce, but on what it is able to consume. The distinction is of vital importance. In the face of almost unlimited demand during the past two or three years, industry has been speeded up through the use of specialized machinery to a degree which justifies calling this period a super-machine era in industry. Total production, even with three to four million men withdrawn from industry into the military establishment, has far exceeded pre-war production, both in physical volume and adjusted money value. War has been the consumer. The same volume of production of commodities for the public cannot be maintained because increased consumption comes gradually with the education of the people to higher standards of living, and maintenance of this volume with only the domestic public as a market would be impossible, would lead to a reaction and a clogging of the market.

Moreover, the returning soldiers must be absorbed back into industry. They must help to produce something that is wanted. It is difficult to retrace forward steps, such as the advancement of industry through increased use of machinery, but it is more important to have industry stabilized on a smaller volume than to aim at a height that might be reached only to topple over.

A careful estimate should at once be made in order to determine the probable amount of the future demand for the products of American industry from the following sources: (a) Reconstruction of Belgium, France, Serbia, and Russia; (b) Commercial export market in Europe, South America, and the Orient; (c) Railroad reconstruction at home; (d) Public works at home; (e) Domestic use of consumable products, present and potential.

Perhaps the most important element in this problem is the maintenance of public confidence. The business man must appreciate that a sharp reaction can be avoided only by controlling the industrial cycle. The banks must not restrict credits too sharply. The War Finance Corporation must stand ready to relieve them in an emergency. Stabilizing of credits during this transition period will be one of the most important functions of the government, to be accomplished directly by lending through the War Finance

Corporation and indirectly by encouraging a broad spirit of optimism.

2. *Restoration of a normal price level.*—It should be assumed that prices, including wages, must come down ultimately, and there is no blinking the fact that a falling market entails loss to all who at the time are "long" on any of the materials or commodities whose values are thus affected.

There will inevitably be a falling market in this country, for the reason that we have been and are about to produce more than we can consume at home or sell abroad. The main problem is how to place the loss where it can be absorbed most readily, without upsetting industry. Stabilization of this process is the most vital function of the government in the process of reconstruction.

Restoration of a normal price level requires a close study of: (a) The natural economic forces which brought about the present situation and how they were controlled in the process; (b) The economic forces that would operate naturally to restore a normal price level, and how they must be controlled.

With regard to (a), the main economic factor, other than the shortage of labor, has been the sharply increased and sustained demand for raw materials. Prices advanced automatically to stimulate the production of an additional supply, resulting in:

1. Increased value (unearned) of all stocks held by original producers; by manufacturers of raw materials, of goods in process of manufacture, and of finished products; by wholesalers and retailers. .

2. Increased value of undeveloped supply, resulting in increased production by established producers; increased number of producers; increased profits; both quantitative increase in total profits and increase in rate of profit for unit of output.

3. Increased price of finished products in general, resulting in increased cost of living; increased wages; decreased non-government demand causing reduced stocks in hands of dealers and decreased distributing organization.

With regard to (b), the main economic factor will be the decreased demand for both labor and materials. The price of raw materials will decline automatically to check production, resulting in:

1. Decreased value of all stocks held by original producers; by government; by manufacturers of raw materials, of goods in process of production, and of finished products; by wholesalers and retailers.

2. Decreased value of undeveloped supply, resulting in decreased production by established producers; decreased number of producers; decreased profits, both quantitative decrease in total profits and decreased rate of profit per unit of output.

3. Decreased price of finished products, resulting in decreased cost of living; decreased wages; increased non-government demand causing increased stocks in hands of dealers and increased distributing organization.

During industrial preparation for war the government interfered with the normal operation of economic forces for the purpose of avoiding a shortage of the materials needed and conserving them for war purposes. During industrial reconstruction after the war government control should be exerted to avoid a glut of the market by the "dumping" of stocks now on hand in the face of a diminished demand.

During the war period materials were conserved and the market stabilized by a system of maximum prices combined with a strict rationing and the use of priorities in transportation. After the war the problem will be to stabilize falling prices and get the supply absorbed. Instead of rationing and maximum-price fixing, the process should be one of guaranteeing a minimum price over a limited period and holding the supply open to any purchaser at the fixed price.

To protect against "dumping" the government must retain control of those stocks of raw materials and materials in process of manufacture which it owns outright or for which it is liable under war contracts. This means that instead of directing a manufacturing contractor to sell out his stock at market prices in order to ascertain the amount of damages that would accrue on cancellation of the contract, the government will continue in force an agreement to accept the stock at its cost to the manufacturer. The process would then be the gradual liquidation of the excess materials which it owns or controls.

The first step in this liquidation would be the fixing of a minimum price at less than the cost of the materials to marginal

producers, non-war industries, and dealers, including the government, letting the loss lie where it falls. The government must stand ready to take everything that is offered at the fixed price, but inasmuch as the effect of a reduced price will be to discourage excess production, this amount would not be overwhelming. After a certain period the minimum price should again be lowered, and so on until the supply is adjusted on a fair price. Downward changes in the minimum price must not be so abrupt as to wipe out entirely the margins on which business is done, nor should the fatal day be postponed too long.

This plan divides the loss due to shrinkage in values between the government and private non-war industry. It is flexible and can be adjusted to any basis, either of price or period of time. Although the plan may seem costly to the government, any loss would be preferable to the disorganization of industry that would follow unrestrained liquidation by the government and war industries alike in a falling market.

Control of priorities should be continued to prevent underselling.

Before definite plans can be worked out for the administration of government stocks, it will be necessary to have the following information concerning each basic material:

1. How much has average monthly production increased over pre-war production?
2. What stocks are on hand today in hands of producers? in hands of government? What stocks are in hands of war contractors in raw materials? in goods in process of manufacture? in completed products?
3. What is the salvage value of fabricated and partially fabricated materials in hands of war contractors whose products will not be required by the government?
4. How much has non-government demand increased or decreased during the war period?
5. What government contracts or guarantees are outstanding for raw materials not yet produced?

With this information it will be possible to determine what contracts for future production of raw materials should be canceled, what minimum price should be fixed in order not to wipe out the

entire margin of non-war manufacturers, and how the stocks on hand should be administered by the government.

3. *Conversion of industrial facilities.*—Those industrial plants which are devoted to the manufacture of munitions or other supplies for which the government is the only purchaser must ultimately be converted for the production of commodities for which there is a market at home or abroad. This process of conversion will entail the scrapping of specialized equipment, the selection of new lines of manufacturing, and the use of capital to install new equipment and build up a distributing system and a market.

Conversion of industrial facilities should be carried on in such a way as to avoid ruinous competition when the process is completed; that is, there should be government control of the *direction* of industry which may be exercised through (a) a strict rationing of investment capital and (b) extension of government credit or underwriting of risks in new fields.

Control cannot logically be exercised through rationing of raw materials, for there is reason to believe, as already pointed out, that there will be a surplus of raw materials, and one of the main objects of the government will be to get them into use. The strategic point lies in the control of capital through the Federal Reserve Board, the Capital Issues Committee, and the War Finance Corporation, whose powers should be broadened to enable them to handle the problem.

Industry must be balanced. The government must be prepared not only to restrict but to advise definitely respecting markets abroad and at home. Overcrowding of a particular industry must be avoided. The government, acting through whatever agencies will exercise control and extend aid, should have the necessary information respecting the condition of the various industries as a basis for its regulation.

4. *Absorption of labor.*—The extent and importance of this problem depend upon (a) the policy of the government in canceling contracts and curtailing orders in war industries, (b) the rate of return of discharged soldiers, and (c) the readiness with which the three preceding problems discussed herein are solved. Wasteful competition among labor is even worse in its political and social

aspects than wasteful competition among capital in industry; hence it may be necessary for the government to stabilize wages on a descending scale, following as closely as possible the fall in commodity prices.

It is assumed that no effort will be made by any agency of the government to stabilize present money wages, but that all will recognize that the maintenance of a given standard of living depends on the relation of wages to commodity prices, rather than on the rate of wages. If this principle is held steadily before those in charge of wage adjustments after the war, in the face of outside pressure, the solution of the problem will be simplified.

Serious unemployment in the transition period of industry can be avoided by a careful program involving the following:

a) Stimulation of local public works of a productive character, such as roads, bridges, sewers, school buildings, irrigation and reclamation projects, etc.

b) Use of government funds in public works for buildings, development of transportation, natural resources, etc.

c) Active government employment agencies to classify sectional demands for labor in advance of the discharge of soldiers, in order that demobilization may be synchronized with the creation of opportunities.

d) Control of minimum wages, exerted directly through the Labor Department, or indirectly as a condition to the use of capital or the extension of government aid to industry.

In conclusion, it should be unnecessary to state that this memorandum has been written with conscious disregard of the many qualifying political factors and general policies with which any program of reconstruction must be in harmony. The merits of paternalism and the centralization of power are not debated here. No consideration is given to the possible conflict between the several recommendations and suggestions contained herein and the customs and institutions of the people. The memorandum is intended to serve as a preliminary outline only, and not as a working program.

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